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## Crash of nations

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### Abstract:

**Sachs** discusses the disparity between the recent US pledge to help support the Mexican economy and the US's failure to offer similar support to Russia. The reason is that Wall Street does not have its money in Russia.

### Full Text:

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Bill Clinton justified his \$40 billion loan guarantee to Mexico with the thought that America must continue to lead the world. The collapse of Russia's reforms in the ashes of Grozny mocks those words. While it took the United States less than two weeks to commit more than \$40 billion of credit lines to Mexico, we failed to supply even one-tenth that amount in loans, loan guarantees and grants to Russia's reformers during the past three years. Aid to Russia was surely vital for our security and foreign policy goals, and was justifiable by the same logic as the Mexican package. But for Russia, which has plunged into civil violence and now teeters on dictatorship, we heard only the bipartisan foreign policy bleating that there is simply no money, or, as George Bush memorably put it in 1989, "We have more will than wallet."

The contrast between Mexico and Russia speaks volumes about the degradation of our foreign policy during the past two administrations. The alacrity of the Mexican bailout, in contrast to the neglect of Russia, is largely a result of the baying of the New York financial community, incensed that it had lost some \$10 billion to \$15 billion in the collapse of the Mexico peso last December. The money men demanded that the White House and Congress stanch the losses, and the political leadership immediately heard the message. Even Congress's strongest foes of foreign aid, ever mindful of real politics and campaign financing, immediately jumped on board.

The case for a well-designed bailout package for Mexico is real, even if aid is being spurred by sore losers in the financial community. A well-designed aid package will help to stabilize the Mexican economy, and international capital markets more generally, at low cost (or even no cost) to the U.S. budget. Of course, the overeager Clinton administration could still spoil the Mexican package if it simply forks over the money without strong conditionality on Mexico's financial policies, or if it goes overboard to try to save the bankers, rather than Mexico, at taxpayers' risk.

Russia's tragedy is that no investment banker's Christmas bonus has ever depended on Russia's financial stability. As economic adviser to Russia until I resigned in frustration in January 1994, I described at

painstaking length to Washington, the IMF and the World Bank the logic of a package of financial guarantees for Russia along the lines of the Mexican package. I argued that a government in financial distress needs backstopping in the form of long-term loans or loan guarantees, so that it can roll over its debts, meet crucial payrolls and reestablish its creditworthiness without a financial meltdown. I warned that a currency, such as the Russian ruble or Mexican peso, that lacks external backing can produce a vicious circle of depreciation, inflation and political instability, as a result of a self-fulfilling panic in the financial markets.

All the while, I was met with blank stares from U.S. administration officials, international bureaucrats at the IMF and World Bank, and most with whom I spoke in Congress. Turbulent markets, I was told repeatedly, simply reflect understandable doubts of investors. If a currency is falling, the government needs a change of policy, certainly not a foreign loan guarantee. Leading economists at the World Bank lectured me that the most important thing in an aid program is to avoid giving money too soon, lest it be wasted. Anyway, practical people "knew" there was simply no money available in an era of pinched budgets in all the leading countries. Somehow, we have found \$40 billion of loan guarantees for Mexico in the year of the balanced budget amendment.

In 1992, the fateful first year of Russian democracy, the Yeltsin reform cabinet was left naked to destabilizing market forces, with creditors unwilling to roll over old Soviet debts or to extend new loans to the Russian government. With the short-term bills on the old debts rapidly piling up, zero foreign reserves and the IMF'S rejection of Yegor Gaidar's urgent request for a \$6 billion ruble stabilization fund and other credits, it is no wonder Russians fled their currency, just as the U.S. Treasury feared would happen in Mexico if we failed to give aid.

With the new Russian government against the wall, Russian money-holders and enterprises adopted four rules of behavior that eventually toppled the reforms. First, hold dollars, not rubles. Second, refuse to buy Russian government bonds except at loan-shark rates, since the old Soviet debts are piling up and the government can't find international backers. Third, withhold tax payments, since delays in tax payments are tantamount to tax cuts when the currency is rapidly losing its value. Fourth, count on the reform cabinet to fall. Without backstopping from the outside world, Gaidar's days were numbered. Military-industrial enterprises could bide their time, leaving their bills unpaid, until the reform government was toppled. Sure enough, by December 1992, it was.

Those who think this outcome was inevitable understand little about actual Russian politics or basic economics in that crucial year. The budget deficit was actually manageable at the start, before three years of political instability took their toll on tax evasion and subsidies. Russia's foreign debts as a percentage of national income were about the same as in Mexico. The reformers had the support of the people, especially as goods poured back into the shops in early 1992 as a result of market reforms. Yeltsin had vastly more authority than the hard-line opposition, which was wrong-footed by the failed hard-line coup in 1991 and was reeling from Yeltsin's thrusts. Under these conditions, Western guarantees could have sustained the Russian reforms, perhaps not for free (as might be the case in Mexico), but at least at a price that would have been one of the great bargains of history.

The Clinton administration carried on the immobilism of Bush and James Baker, missing other chances for financial stabilization in 1993 and perhaps in 1994 (though by then most of the reformers had departed). Yes, Clinton promoted more aid than Bush, but still in amounts too small to be consequential. With each downward turn of politics and finance in Russia, our policymakers have responded with relentless Polyannaish good cheer. After all, Russia must be described as a great U.S. foreign policy success! Each new apparatchik, we're told, is really a reformer in disguise.

Even the recent transfer of effective political power in Russia from democratic institutions to a new politburo, known as the Russian Security Council, seems a mere detail to the State Department. The disastrous and savage Russian attacks in Chechnya, orchestrated by the Security Council, are treated as a footnote. The new privatization minister, who has banished foreign advisers and called for re-nationalizing industry, is really inconsequential.

The costs to us of Russia's retreat from reforms are mounting and will likely rise much higher. Russia has already severely hobbled the Western response to Bosnia. It has stalled the incorporation of Central Europe into NATO. It has increasingly bullied its next-door neighbors, undercutting their prospects of attracting foreign investment. It has agreed to complete a new and dangerous Iranian nuclear plant, despite U.S. protests. Ironically, increases in defense spending in the United States as a result of rising tensions could now amount to several times the money that should have been devoted to aid.

Sadly, the case for aid to Russia is gone for the present, despite the protestations of the administration, which now seems suddenly eager to lend money after years of neglect. We should surely wait to see the political and financial fallout of the Russian war before acting. It would be ludicrous to give aid that would serve to bolster the Russian Security Council or pay for the destruction of Chechnya. We should instead prepare for another chance to help Russian reformers in the future, and use the time to reflect on the havoc that the Bush-Clinton foreign policy has helped to bring about.

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